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No. 90-727

In The

Supreme Court of the United States

October Term, 1990

ROBERT G. HOLMES, JR.,

Petitioner,

vs.

SECURITIES INVESTOR PROTECTION CORPORATION, et al.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITIONER'S BRIEF

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QUESTIONS PRESENTED

1. Whether a person who asserts a claim under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), predicated upon violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and who was neither a purchaser nor a seller of securities and for that reason lacked standing to sue under Section 10(b) and Rule 10b-5, is injured "in his business or property by reason of" such violations, sufficient to acquire standing to sue for essentially the same claims under RICO.

2. Whether a person has standing under RICO to complain of injury by racketeering activity which consists of offenses by the defendant "involving fraud in the sale of securities," when the person was neither a purchaser nor seller of securities.

3. Whether a person, who is neither a purchaser nor a seller of securities, and therefore lacks standing to sue under Exchange Act Section 10(b) and Rule 10b-5, should be permitted to circumvent that limitation on standing by claiming essentially the same conduct as predicate acts of mail and wire fraud.

LIST OF PARTIES

The petitioner is Robert G. Holmes, Jr. Respondents are the Securities Investor Protection Corporation, Eugene W. Bell, trustee for the liquidation of Joseph Sebag Incorporated, and Laurence A. Schroeder, successor trustee for the liquidation of First State Securities Corporation.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	vi
LIST OF PARTIES	ii
OPINIONS BELOW	1
JURISDICTION	1
STATUTES INVOLVED	2
STATEMENT OF THE CASE	2
I. Background	2
II. The Parties In The Courts Below	3
III. The Proceedings Below	4
A. The District Court's Rulings	5
B. The Ninth Circuit's Reversal	6
SUMMARY OF ARGUMENT	6
ARGUMENT	8
I. INTRODUCTION	8
II. A PERSON SUCH AS SIPC HERE, WHO ALLEGES FRAUD IN THE SALE OF SECURITIES AS A RICO PREDICATE ACT, BUT WHO WAS NEITHER A PURCHASER NOR SELLER OF SECURITIES, CANNOT HAVE BEEN "INJURED IN HIS BUSINESS OR PROPERTY" WITHIN THE MEANING OF RICO §1964(c) AND FOR THAT REASON LACKS STANDING TO CLAIM THE FRAUD AS A PREDICATE ACT OF RACKETEERING ACTIVITY	9

TABLE OF CONTENTS – Continued

Page

III. A PERSON SUCH AS SIPC HERE, WHO ALLEGES FRAUD IN THE SALE OF SECURITIES AS A RICO PREDICATE ACT, BUT WHO WAS NEITHER A PURCHASER NOR SELLER OF SECURITIES, LACKS CIVIL RICO STANDING UNDER §1964(c) TO CLAIM TO HAVE BEEN INJURED "BY REASON OF" THE FRAUD 16

IV. ON ITS FACE, RICO §1964(c) INCORPORATES BY REFERENCE STANDING REQUIREMENTS UNDER THE EXCHANGE ACT WHEN IT INCORPORATES BY REFERENCE THE BODY OF LAW PERTAINING TO FRAUD IN THE SALE OF SECURITIES..... 21

V. THE RELATIVELY NARROW DEFINITION OF "RACKETEERING ACTIVITY" CONTAINED IN RICO §1961(1)(D) CONSISTING OF AN "OFFENSE INVOLVING FRAUD IN THE SALE OF SECURITIES" REFLECTS AN INTENTION TO PRESERVE APPROPRIATE STANDING LIMITATIONS..... 25

VI. IN ADOPTING RICO, CONGRESS DID NOT INTEND TO OVERRULE, ELIMINATE OR EMASCULATE THE PURCHASER-SELLER STANDING REQUIREMENT PERTAINING TO FRAUD IN THE SALE OF SECURITIES.. 28

VII. SOUND AND APPROPRIATE JUDICIAL POLICY REQUIRE THAT WELL-SETTLED AND WIDELY ACCEPTED PRINCIPLES OF STANDING UNDER THE EXCHANGE ACT APPLY UNDER RICO WHEN FRAUD IN THE SALE OF SECURITIES IS ALLEGED AS A PREDICATE ACT OF "RACKETEERING ACTIVITY." 31

TABLE OF CONTENTS – Continued

Page

A. It is Appropriate to Consider Matters of Judicial Policy 31

B. The Policy Considerations Which Led to Adoption of the Purchaser-Seller Standing Requirement Apply With Even More Force When Securities Fraud is Alleged as a Predicate Act of "Racketeering Activity." 33

C. Disregarding The Purchaser-Seller Standing Limitation Under RICO Would Unjustly Emasculate and Trivialize a Well Settled and Widely Accepted Principle of the Law of Securities Fraud 36

VIII. THE DECISION BELOW WAS CLEARLY ERRONEOUS AND SHOULD BE REVERSED AND THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE CIRCUITS BY ADOPTING THE VIEWS EXPRESSED BY THE FOURTH CIRCUIT ON RICO STANDING ... 38

IX. THE PURCHASER-SELLER STANDING REQUIREMENT OF FRAUD IN THE SALE OF SECURITIES SHOULD NOT BE CIRCUMVENTED BY PERMITTING THE PLEADING OF WIRE OR MAIL FRAUD AS A PREDICATE ACT OF RACKETEERING ACTIVITY ABSENT A SHOWING OF REQUISITE SECURITIES FRAUD STANDING 41

X. CONCLUSION 44

TABLE OF AUTHORITIES

Page

CASES

Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952) .... *passim*

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) ..... *passim*

Brandenburg v. Seidel, 859 F.2d 1179 (4th Cir. 1988) 43

Brannan v. Eisenstein, 804 F.2d 1041 (8th Cir. 1986) .37, 44

Celotex Corp. v. Catrett, 477 U.S. 317 (1986) 5

Chief Consol. Mining Co. v. Sunshine Mining Co., 725 F.Supp. 1191 (D.C. Utah 1989) 24

County of Suffolk v. Long Island Lighting Co., 907 F.2d 1295 (2d Cir. 1990) 43

Craig v. First Am. Capital Resources, Inc., 740 F. Supp. 530 (N.D. Ill. 1990)..... 18

First Pac. Bancorp, Inc. v. Bro., 847 F.2d 542 (9th Cir. 1988)..... 27

Flynn v. Merrick, 881 F.2d 446 (7th Cir. 1989)..... 12

Grafman v. Century Broadcasting Corp., 727 F. Supp. 432 (N.D. Ill. 1989) 12

H.J., Inc. v. Northwestern Bell Tel. Co., 492 U.S. 229, 106 L.Ed.2d 195 (1989).....18, 27, 33, 41, 42

Illinois v. Life of Mid-America Ins. Co., 805 F.2d 763 (7th Cir. 1986)..... 10

International Data Bank, Ltd. v. Zepkin, 812 F.2d 149 (4th Cir. 1987)..... *passim*

Liquid Air Corp. v. Rogers, 834 F.2d 1297 (7th Cir. 1987)..... 23

TABLE OF AUTHORITIES – Continued

Page

Morast v. Lance, 807 F.2d 926 (11th Cir. 1987)..... 10

Moss v. Morgan Stanley, Inc., 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984)..... 23, 24, 37

National Enter., Inc. v. Mellon Fin. Serv. Corp., 847 F.2d 251 (5th Cir. 1988).....10, 11

Ohashi v. Verit Industries, 536 F.2d 849 (9th Cir. 1976), *cert. denied*, 429 U.S. 1004 (1976)..... 17

Pelletier v. Zweifel, 921 F.2d 1465 (11th Cir. 1991) 43

Rylewicz v. Beaton Serv., Ltd., 888 F.2d 1175 (7th Cir. 1989).....10, 11

Securities Investor Protection Corp. v. Vigman, 908 F.2d 1461 (9th Cir. 1990)..... 38

Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479 (1985). *passim*

Sperber v. Boesky, 849 F.2d 64 (2d Cir. 1988) 43

United States v. Turkette, 452 U.S. 576 (1981).....29, 40

Warner v. Alexander, Grant and Co., 828 F.2d 1528 (11th Cir. 1987)..... 40

Warren v. Manufacturers Nat'l Bank, 759 F.2d 542 (6th Cir. 1985)..... .....10, 12

Wooten v. Loshbough, 738 F. Supp. 314 (N.D. Ind. 1990).....12, 19

TABLE OF AUTHORITIES – Continued

Page

STATUTES AND REGULATIONS:

Racketeer Influenced and Corrupt Organization Act
18 U.S.C. §1961 ..... 2, 3, 21, 23, 25

18 U.S.C. §1961(1)(D) 10, 21, 22, 26

18 U.S.C. §1962 ..... 9, 10, 21

18 U.S.C. §1962(b)(1) 10

18 U.S.C. §1962(c) 10

18 U.S.C. §1962(d) 10

18 U.S.C. §1964 ..... 16, 22, 23

18 U.S.C. §1964(c) ..... *passim*

1933 Securities Act 15 U.S.C. §77x 26

Securities and Exchange Commission Rule 10b-5,
17 C.F.R. §240.10b-5 ..... *passim*

Securities Exchange Act of 1934
15 U.S.C. §78ff 26

15 U.S.C. §78j(b) 2, 3

Securities Investor Protection Act
15 U.S.C. §§78aaaa-78111 2

15 U.S.C. §78fff-3 20

MISCELLANEOUS:

Blakey, *Foreward* to *Law and the Continuing Enterprise: Perspectives on Rico,* 65 Notre Dame L. Rev.873 (1990) 22

TABLE OF AUTHORITIES – Continued

Page

Bridges, Private RICO Litigation Based Upon "Fraud In The Sale of Securities," 18 Ga. L.Rev. 43 29

J.S. Rakoff and H.W. Goldstein, RICO: Civil and Criminal Law Strategy §2.02(1) (1991) 43

Senate Report No. 617 91st Cong. 1st Sess. (1969) .29, 30

OPINIONS BELOW

The Opinion and Judgment of the United States Court of Appeals for the Ninth Circuit was entered on August 3, 1990, is reported at 908 F.2d 1461 (9th Cir. 1990) and is printed in Appendix A of the Petition for Writ of Certiorari ("Pet. App. A") at page 1a. The Orders for Summary Judgment of the United States District Court for the Central District of California are printed in Pet. App. A, at pages 22a-46a. Other opinions, not at issue on this writ of certiorari, rendered at earlier points in this case by the United States Court of Appeals for the Ninth Circuit are reported at 764 F.2d 1309 (9th Cir. 1985) and at 803 F.2d 1513 (9th Cir. 1986) and are printed in Pet. App. A, at pages 64a and 46a, respectively.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit (Pet. App. A, at page 1a) was entered on August 3, 1990. The Petition for Writ of Certiorari was filed on November 1, 1990 and was granted on April 22, 1991 limited to Question 1 of the Petition relating to whether a person who is neither a purchaser nor seller of securities and lacks standing under the Exchange Act may sue for essentially the same conduct under RICO. The jurisdiction of the Supreme Court is invoked under 28 U.S.C.A. §1254(1) (West 1966 & Supp. 1991).

STATUTES INVOLVED

1. The Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C.A. §§1961-1968 (West. 1984), printed in Pet. App. A, at page 86a.

2. The Securities Exchange Act of 1934, 15 U.S.C.S. §78j(b) (Law. Co-op. 1983), and Securities and Exchange Commission Rule 10b-5, 17 CFR §240.10b-5, printed in Pet. App. A, at page 97a.

3. The Securities Investor Protection Act, 15 U.S.C.S. §§78aaa-78lll (Law. Co-op. 1983), printed in Pet. App. A, at page 98a.

STATEMENT OF THE CASE

I.

Background

In 1981, the Securities Investor Protection Corporation ("SIPC") placed two securities brokerage firms, First State Securities Corporation ("FSSC") and Joseph Sebag, Inc. ("Sebag") in liquidation, pursuant to the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§78aaa-78lll, when FSSC and Sebag failed to meet statutory net capital requirements. SIPC appointed trustees to administer the liquidation of FSSC and Sebag and to return customer property and settle customer claims against the brokerage firms.

In 1983, SIPC and the trustees brought this action against Petitioner Robert G. Holmes, Jr. ("Holmes") and seventy-five other defendants to recover payments made allegedly as a result of conspiracy among the defendants to manipulate, through FSSC and Sebag, the prices of

securities of six publicly traded corporations. SIPC and the trustees asserted claims under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961-1968 ("RICO") and the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78j(b) and Rule 10b-5 promulgated thereunder.[1]

II.

The Parties In The Courts Below

Petitioner Holmes is the founder, chief executive officer, president and a major shareholder of Aero Systems, Inc. ("Aero"). Aero is one of the six corporations whose stock SIPC alleges was manipulated.

SIPC was established in 1970 by the Congress pursuant to the SIPA. Among other purposes, SIPC was empowered to reimburse customer claims when member securities brokerages went into liquidation due to financial failure and had insufficient assets to meet customer claims. SIPC alleges that it had to disburse nearly $13,000,000 to meet claims of customers of FSSC and Sebag which FSSC's and Sebag's assets were insufficient to satisfy. SIPC sued Holmes and other defendants to recover payments required to be made by SIPC to certain customers of the failed brokerage firms. The trustees, the other appellants below, were appointed to liquidate FSSC and Sebag and separately sued Holmes and others for the destruction of the business and loss of goodwill of FSSC and Sebag.

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[1] RICO, 18 U.S.C.A. §§1961-1968 (West 1984), is printed in Pet. App. A, at page 86a; Exchange Act Section 10(b), 15 U.S.C.S. §78j(b) (Law. Co-op. 1983) and Rule 10b-5, 17 CFR §240.10b-5, are printed in Pet. App. A, at pages 97a and 98a respectively.

In addition, customers of FSSC and Sebag, who were purchasers or sellers of the allegedly manipulated securities, brought a separate class action against Holmes and the other defendants, which action has been partially resolved by settlement with Holmes and certain other defendants.

III.

The Proceedings Below

Holmes moved for summary judgment in the District Court for the Central District of California (the "District Court") on the grounds, among others, that SIPC had no standing to maintain claims against him under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder because SIPC was not a purchaser or seller of the allegedly manipulated securities. Holmes also asserted that he was not liable to either SIPC or to the trustees because his acts, taken alone or in conjunction with those of others, were not the proximate cause of the financial failure of the brokerages. Holmes also argued that SIPC and the trustees had no standing under RICO to sue him for the failure of the brokerage firms because SIPC's and the trustees' damages were not caused "by reason of" the alleged RICO violations. Furthermore, SIPC did not have standing to assert RICO claims against Holmes which were predicated upon Holmes' alleged offenses under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder because SIPC, not having been a purchaser or seller of the securities, had no standing to assert the alleged predicate claims.

In the courts below, SIPC and the trustees argued that Holmes, acting in concert with others, caused the demise of

FSSC and Sebag by artificially inflating the price of Aero's stock through the issuance of false and misleading press releases. The plaintiffs argued that the alleged inflated price of Aero stock enabled the brokerages to acquire massive inventories of other allegedly manipulated stock. The plaintiffs argued that these excess inventories, together with a conspiracy in which Holmes and others allegedly participated involving another security, Bunnington Corporation, were the reason for FSSC's and Sebag's failure because the price of the stocks dropped when the alleged manipulations were discovered.

Holmes denied inflating the price of Aero's stock artificially or participating in any manipulation of Bunnington Corporation securities and argued that even if he did, that manipulation was not the cause of the failure of the brokerages. The failure of the brokerages was caused by wrongdoing of Joseph Lugo, a principal and brokerage officer of FSSC and Rodger Garrity, a former brokerage officer of Sebag, who manipulated securities between themselves and engaged in other wrongdoing, none of which involved Holmes.

A. The District Court's Rulings

In ruling on Holmes' motions for summary judgment, the District Court concluded that Holmes' conduct was not sufficiently connected to SIPC's nor the trustees' losses to have been a proximate cause of those losses. The District Court also ruled that SIPC had no standing to assert RICO claims predicated upon violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder because SIPC had not carried its burden of proof under *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986), to show that it

was a purchaser or seller of securities. *See* District Court's Conclusions of Law, printed in Pet. App. A, at pp. 27a-28a. Furthermore, the District Court concluded that Holmes was entitled to summary judgment with respect to both the Exchange Act claims and the RICO claims because Holmes' conduct was not causally connected to SIPC's or the trustees' losses. The District Court granted summary judgment to Holmes on both the Rule 10b-5 and the RICO claims for the reasons that SIPC had not shown that it was a purchaser or seller of securities and there was lack of a causal nexus between Holmes' conduct and the plaintiffs' losses.

B. The Ninth Circuit's Reversal

The Court of Appeals for the Ninth Circuit reversed the District Court's ruling and held that SIPC need not have been a purchaser or a seller of securities in order to acquire standing to assert RICO claims predicated upon Holmes' alleged violations of Exchange Act Section 10(b) and Rule 10b-5. The Ninth Circuit also reversed the District Court's ruling that Holmes' conduct was not a proximate cause of the plaintiffs' injuries. This Court granted a writ of certiorari with respect to the Ninth Circuit's holding that SIPC need not have been a purchaser or seller of securities to assert claims under RICO predicated upon allegations against Holmes of offenses involving fraud in the sale of securities.

SUMMARY OF ARGUMENT

It is inherent in the civil RICO standing provision, §1964(c), which confers standing on a person "injured in

his business or property," that the injury be "direct." A person who is neither a purchaser nor seller of securities is not directly injured in a "fraud in the sale of securities."

Civil RICO standing exists only when the claimant was injured "by reason of" the predicate act of racketeering activity. A person who is neither a purchaser nor seller of securities is not sufficiently causally connected to a fraud in the sale of securities to satisfy this requirement.

RICO §1964(c), which contains the civil RICO standing provision, incorporates by reference the purchaser-seller standing requirement when it incorporates by reference the body of law pertaining to "fraud in the sale of securities."

The only definition of "racketeering activity" in RICO which relates to securities, "fraud in the sale of securities," is the most narrowly defined of the approximately 36 predicate acts set forth in RICO. Such purposeful circumscription evidences an intention to preserve existing appropriate standing limitations.

In adopting civil RICO, Congress did not intend to emasculate or trivialize the Exchange Act by overruling well-settled and widely accepted standing provisions contained in existing judicial decisions under the Exchange Act.

Judicial policy considerations are appropriately referred to in resolving the question at hand. To avoid vexatious litigation, discovery abuse, strike suits, settlement pressure, extortion and judicial system abuse, the purchaser-seller standing requirement should be preserved when "fraud in the sale of securities" is alleged as a predicate act of "racketeering activity."

The purchaser-seller standing requirement for fraud in the sale of securities should not be subject to circumvention merely by pleading wire or mail fraud in connection with the same conduct.

ARGUMENT

I.

INTRODUCTION

Standing serves as the gatekeeper to the judicial forum. It admits those entitled to pursue their grievances and bars those who are not. Entry, through standing, is administered by judges applying principles of law, rather than by triers of fact, even though some of the same questions resolved in the context of standing, such as causation and whether the claimant sustained direct injury, could be and sometimes are resolved as factual issues.

Some precepts of standing have evolved into settled and widely accepted principles of law. The opinion in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952) and this Court's decision in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), developed the principle that a person or entity must be a purchaser or seller of securities to have standing to sue under Exchange Act §10(b) and the related Rule 10b-5, and that principle has become solidly embedded in federal securities jurisprudence. On this writ, petitioner asks this Court to determine whether the principles of standing enunciated in *Birnbaum* and *Blue*

Chip Stamps are applicable when "fraud in the sale of securities" set forth at RICO §1961(1)(D) is relied upon under RICO §1964(c) as the "racketeering activity" which violates RICO §1962.

Without persuasive analysis, the Ninth Circuit decision below emasculated the principles established in *Birnbaum* and *Blue Chip Stamps* when securities fraud is used as a predicate act of racketeering activity and that decision undermines the stability and predictability of a well-settled body of law. The Ninth Circuit, while purportedly basing its decision on the language of RICO, in fact ignored the realistic plain meaning of that statute. An examination of the language of RICO, related congressional history and appropriate policy considerations indicates that, contrary to the ruling below, a person or entity that is neither a purchaser nor seller of securities and who or which, for that reason lacks standing under the Exchange Act to sue for fraud in the sale of securities, similarly lacks standing to claim injury by "fraud in the sale of securities" as "racketeering activity" under RICO.

II.

A PERSON SUCH AS SIPC HERE, WHO ALLEGES FRAUD IN THE SALE OF SECURITIES AS A RICO PREDICATE ACT, BUT WHO WAS NEITHER A PURCHASER NOR SELLER OF SECURITIES, CANNOT HAVE BEEN "INJURED IN HIS BUSINESS OR PROPERTY" WITHIN THE MEANING OF RICO §1964(c) AND FOR THAT REASON LACKS STANDING TO CLAIM THE FRAUD AS A PREDICATE ACT OF RACKETEERING ACTIVITY.

RICO §1964(c), commonly referred to as the core of the civil RICO provisions, contains the standing

requirement for civil RICO. It provides that "[a]ny person injured in his business or property by reason of a violation of §1962 . . . may sue therefor . . . . " RICO §1962 prohibits using or investing the proceeds of a pattern of racketeering activity (RICO §1962(a)), using a pattern of racketeering activity to acquire an interest in or to maintain control of an enterprise (RICO §1962(b)(1)), conducting or participating in an enterprises's affairs through a pattern of racketeering activity (RICO §1962(c)), or conspiring to violate any of the foregoing (RICO §1962(d)). Thus, determining the existence of "racketeering activity" is essential to determining whether there has been a violation of RICO §1962 and, accordingly, whether there is standing to invoke civil RICO under §1964(c). "Racketeering activity" is defined to include "any offense" involving "fraud in the sale of securities . . . punishable under any law of the United States." RICO §1961(1)(D).

It has consistently been held in several circuits that only the party directly injured has standing to invoke civil RICO.[2] For example, when a corporation is injured by an act of racketeering activity, a shareholder of the injured corporation may not bring an individual claim in his capacity as a shareholder for the diminution in the value of his shares. Only the injured corporation is the directly injured party and has standing to invoke civil RICO. *See Rylewicz v. Beaton Serv., Ltd.*, 888 F.2d 1175

[2] *See, e.g. National Enter. Inc. v. Mellon Fin. Ser. Corp.*, 847 F.2d 251 (5th Cir. 1988); *Morast v. Lance*, 807 F.2d 926 (11th Cir. 1987); *Illinois v. Life of Mid-America Ins. Co.*, 805 F.2d 763 (7th Cir. 1986); *Warren v. Manufacturers Nat'l Bank of Detroit*, 759 F.2d 542 (6th Cir. 1985).

(7th Cir. 1989). Indeed, "[t]he standing rule that stockholders may not bring individual claims under RICO for diminution in the value of the corporation prevails in all the Circuits that have considered the matter." *Id.* at 1179.[3]

A principle reason for granting standing only to the directly injured party is to prevent multiple recoveries for the same injury. For example, when the victim is a corporation, if its shareholders, employees and suppliers were each individually considered to be a "person injured in his business or property" entitled to assert a civil RICO claim for the same injury, there could be innumerable recoveries, each with treble damages. No such result was intended by Congress or has been countenanced by the courts.

The requirement for a "direct injury" to the plaintiff in order for the plaintiff to have standing was applied in *National Enter. Inc. v. Mellon Fin. Ser. Corp.*, 847 F.2d 251 (5th Cir. 1988). There, the creditors of a corporation which was the victim of an act of racketeering activity were held to lack standing to sue the perpetrator. The *National Enterprises* court illustrated what could happen if the "direct injury" requirement of civil RICO standing was relaxed. Taxpayers only indirectly injured by a fraud perpetrated on a county could claim standing; an insured could claim standing to sue an insurance agent for causing his insurance company to become bankrupt; and union members would have standing to sue those who committed acts of racketeering activity against the union. In fact, courts have determined in each of the foregoing

[3] The *Rylewicz* court cites decisions in the Fifth, Eleventh, First, Second and Sixth Circuit to the same effect. *See Rylewicz*, 888 F.2d at 1179.

contexts that the plaintiff lacks standing. *See Id.; see also Warren v. Manufacturers Nat'l Bank of Detroit*, 759 F.2d 542, 545 (6th Cir. 1985) ("Whether RICO should or should not be interpreted to 'federalize' common law fraud is an issue distinct from whether it should be interpreted to materially expand the standing requirement applicable to such claims."); *Flynn v. Merrick*, 881 F.2d 446 (7th Cir. 1989) (shareholder and debentureholder did not have standing under civil RICO to sue for an injury suffered by the corporation in which they were shareholders and debentureholders).

In *Wooten v. Loshbough*, 738 F.Supp. 314 (N.D. Ind. 1990), the court applied the same RICO standing principles discussed above. The plaintiff in *Wooten* was a judgment creditor of a press machine manufacturer as a result of obtaining a judgment against the manufacturer arising from a personal injury sustained by plaintiff. The plaintiff sued a third party for perpetrating racketeering activity against the manufacturer with respect to which plaintiff was a judgment creditor. The court ruled that the plaintiff had no standing to sue under civil RICO for injury suffered by the manufacturer, which caused the manufacturer to divert funds which rendered the manufacturer unable to satisfy the plaintiff's judgment.

The plaintiff's injury, reasoned the court, flowed only indirectly from the injury sustained by the manufacturing corporation and was therefore not assertable by the plaintiff, merely one of the victim's creditors. The perpetrators of racketeering activity plundered the corporation, not plaintiff, and plaintiff's inability to enforce her judgment against the corporation was an indirect result of activities undertaken against the corporation. *Id.* at 317. *See also Grafman v. Century Broadcasting Corp.*, 727 F. Supp. 432 (N.D. Ill. 1989) (standing under civil RICO denied to a

shareholder and director who sought to sue for racketeering activity directed against the corporation).

In the context of a sale of securities, of necessity and by definition of "sale," the parties directly involved in the transaction are the purchaser and seller. The effects of each party's conduct impacts the other directly. A fraud committed by either in connection with the sale directly damages the other, whether because the seller's fraud has increased the price the buyer pays or the buyer's fraud has wrongfully decreased the proceeds of sale to the seller. Anyone else impacted by fraud of the buyer or seller, such as a prospective buyer or seller who chose not to buy or sell, or a person who arrives on the scene subsequent to the fraud and claims economic harm, such as SIPC here, is injured indirectly, not directly, by the fraudulent conduct.

That the plaintiff must demonstrate a direct injury in order to acquire standing when fraud in the sale of securities is the predicate act of racketeering activity was established by the Fourth Circuit in *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987). The Fourth Circuit ruled that a corporation that was neither a purchaser nor seller of its own securities did not have civil RICO standing to sue two individuals who prepared an allegedly misleading securities offering prospectus for the corporation. The *International Data Bank* court noted the necessity of limiting civil RICO standing to persons who have suffered a direct harm and precluding standing to those who have suffered indirect harm. Otherwise, if a corporation were harmed by a securities fraud, the corporation's customers, employers or contractors could sue and anyone connected with the victim of racketeering

activity in any capacity could allege some indirect harm, a result not intended under civil RICO. *Id.* at 153.

The soundness of the decision in *International Data Bank* is evident here. SIPC was neither a purchaser nor seller of any of the securities which were allegedly manipulated by Holmes and other defendants. Nor was SIPC the securities brokerage firm allegedly injured by the securities manipulation. Instead, SIPC is an entity whose statutory duties required it to arrive after the fact and pay money to the brokerage firms' customers, most of whom were themselves neither purchasers nor sellers of the allegedly manipulated securities.[4] SIPC was not

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[4] SIPA contains a concise framework, administered by SIPC, for the reimbursement of customers of failed brokerage houses. SIPC is constrained by the requirements of SIPA to reimburse only those customers who have net equity claims against the failed brokerage firm. A brokerage firm customer may have a net equity claim, reimbursable by SIPC, that had nothing to do with the alleged manipulation of the target securities at issue here. Customers of the failed brokerage firms who purchased target securities shared in the fund of customer property set up under SIPA (primarily assets of the defunct brokerage firms belonging to or held in trust for the accounts of customers), and received reimbursement from SIPC to the extent that the fund of customer property did not satisfy the customers' net equity in the customers' account with the defunct brokerage firm. Such customers could and did maintain their own actions against the alleged manipulators of the target securities based on Rule 10b-5 or RICO.

However, certain customers did not purchase the target securities, but also shared in the fund of customer property and received a reimbursement from SIPC. These were customers whose net equity account claims were not satisfied by the customer fund (and who did not have a Rule 10b-5 action

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directly injured by the fraudulent conduct which it claims constituted the racketeering activity. The direct victims of the alleged racketeering activity were open market purchasers and sellers of the allegedly manipulated securities and the failed securities brokerage firms which had a large inventory of the manipulated securities and whose financial condition was adversely affected by the manipulations. SIPC was not even a successor entity to the brokerage firms, but rather a mandatory post-failure statutory contributor to alleviate certain remnants of their demise. SIPC's position is akin to that of a shareholder or creditor of a victim of the fraud who invested capital or extended credit after the fraud was completed, and who was not itself directly injured by the fraud.

The *International Data Bank* court made clear that a person who was neither a purchaser nor a seller of securities should not be viewed as a matter of policy as having

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against Holmes and others because they were not purchasers or sellers of securities of the alleged target securities). SIPC succeeded to their rights by subrogation. These customers had no automatic standing to sue Holmes under RICO to recover for failure of the brokerage houses to satisfy their net equity claims. Yet SIPC has assumed that because of its subrogation to the claims of all customers whose claims against the brokerage firms it has reimbursed, SIPC automatically may sue and recover against Holmes on the basis of such subrogation regardless of whether the reimbursed customers themselves had standing to assert a RICO claim.

To construe RICO standing that broadly would make Holmes a virtual insurer of loss of the customers of the failed brokerage houses. Liability under RICO or otherwise does not extend so far. If the securities in question for which SIPC reimbursed a customer were not manipulated securities, such securities would have had nothing to do with the alleged fraud except for the happenstance that they were traded at the same failed brokerage house.

been directly injured by a fraud in a sale of securities. *See International Data Bank*, 812 F.2d at 154. On the facts of the instant case, where purchasers and sellers of the allegedly manipulated securities and the securities brokerage firms were the direct victims of the disputed conduct, SIPC was far removed from the alleged securities fraud and arrived on the scene after the consequences of the fraudulent activity were fully at rest. SIPC was not directly damaged by the conduct at issue. The wisdom of *International Data Bank* is particularly appropriate here and commends itself to deny SIPC standing under civil RICO.

III.

A PERSON SUCH AS SIPC HERE, WHO ALLEGES FRAUD IN THE SALE OF SECURITIES AS A RICO PREDICATE ACT, BUT WHO WAS NEITHER A PURCHASER NOR SELLER OF SECURITIES, LACKS CIVIL RICO STANDING UNDER §1964(c) TO CLAIM TO HAVE BEEN INJURED "BY REASON OF" THE FRAUD.

Under civil RICO, the concepts of standing and causation are blended as a result of §1964 which grants standing to "any person . . . injured . . . by reason of . . . [racketeering activity]. . . . "

The words "by reason of" in RICO §1964(c) have been construed as requiring a causal connection between the plaintiff's injury and the predicate act of racketeering activity. *See Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985). It is entirely appropriate that this causation requirement appear in the general civil RICO standing section, §1964(c). Indeed, the phrase "by reason of," mandating a causal connection between the racketeering activity and the injury complained of, serves the same function as the phrase "in connection with" under Exchange Act §10(b) and Rule 10b-5, requiring a causal

connection between the claim and the fraud involving the purchase or sale of securities.[5]

Under the Exchange Act, a person who is neither a purchaser nor seller of securities does not have a sufficient causal connection to the fraud in the sale of securities to have standing to complain. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952). Similarly, under civil RICO, when fraud in the sale of securities is the predicate act of racketeering activity, a person who is neither a purchaser nor seller of securities is not injured "by reason of" the fraud in the sale of securities.

In the landmark *Birnbaum* decision, a shareholder of Newport Steel Corp., who was neither a purchaser nor seller of securities, complained of the sale of securities of Newport Steel by defendants to each other. The plaintiff claimed that the sale of a control block of stock, at a premium above market value, enabled the purchaser to obtain a captive source of supply for steel, but damaged the corporation. Plaintiff contended that standing under Rule 10b-5 should not be limited to purchasers or sellers of securities, because Rule 10b-5 proscribes "frauds upon any person" (not unlike the phrase "any person" in RICO §1964(c)). The plaintiff in *Birnbaum* further argued that if the intention of the drafters of Rule 10b-5 was to deal just with purchases or sales of securities, the Rule would not have used the words "in connection with."

The court in *Birnbaum* ruled, without doubting that Congress was motivated by a broad purpose to protect investors from exploitation by insiders (much like

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[5] *See e.g., Ohashi v. Verit Industries*, 536 F.2d 849, 852-3 (9th Cir. 1976), *cert. denied*, 429 U.S. 1004 (1976).

Congress was motivated by a broad purpose in passing RICO), that the precise question was whether Exchange Act §10(b) the Rule 10b-5 were the means chosen to further that broad end. The court noted that Rule 10b-5 may have been somewhat loosely drawn (not unlike comments which have been made by this Court with respect to RICO).[6] Nevertheless, the words "in connection with" in Rule 10b-5 did not invite open-ended remote causal connection and speculation. Accordingly, the court limited standing under Rule 10b-5 to purchasers or sellers of securities. *Birnbaum*, 193 F.2d at 464.

In *Craig v. First Am. Capital Resources, Inc.*, 740 F. Supp. 530 (N.D. Ill. 1990), the district court explicitly described the function of the words "in connection with" in Rule 10b-5, a subject which was implicitly dealt with by the *Birnbaum* court. The court in *Craig* stated, "[t]o satisfy the 'in connection with' language of §10(b) and Rule 10b-5, a plaintiff must show a causal connection between his decision to buy or sell securities and the defendant's fraudulent conduct." *Id.* at 535.

The requirement that there be a sufficient causal connection between the harm complained of and the plaintiff's injury in order for the plaintiff to have standing, which was established under the Exchange Act and Rule 10b-5 by *Birnbaum* and *Craig* among others, is similar to the requirement under civil RICO that the plaintiff must show a causal connection between the injury complained of and the predicate act of racketeering activity. *See Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496-7 (1985). When the predicate act of racketeering activity is "fraud in the sale of securities," the existing body of law pertaining to standing with respect to fraud in the sale of securities is

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[6] *See H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 106 L.Ed.2d 195, 214 (1989).

readily available to evaluate standing and should be utilized. Dealing with the merits of causation may generally be a question of fact for the trier of fact, but where the law has made a clear determination that it is inappropriate for a person lacking causal connection in certain respects to have standing to sue, the question of sufficient causal connection should become one of law for the court to resolve in the context of standing, rather than one of fact for the trier of fact to resolve.

In *Wooten v. Loshbough*, 738 F. Supp. 314 (N.D. Ill. 1990), plaintiff, a judgment creditor of the corporate victim of racketeering activity, was denied standing. Defendants argued that there was an insufficient causal connection between the plaintiff's injury and the racketeering activity. The district court, citing *Sedima*, stated that "causation is a requirement of standing" under RICO, and an extremely attenuated causal connection will not survive a standing attack under RICO. *Id.* at 317. In *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987), the Fourth Circuit noted that the problems of proof that lead to limiting standing under the Exchange Act to purchasers and sellers apply also in the civil RICO context where fraud in the sale of securities constitutes the alleged predicate act of racketeering activity. If nonsellers and nonbuyers were permitted to complain about a nonevent, namely their failure to purchase or sell securities, the problems of proof with respect to causation would be endless. By limiting the class of plaintiffs at least to those who actually dealt in the securities, a rational outer limit is set on standing. Otherwise, participants in securities markets could await development without risk and then assert their claims or, as with SIPC, arrive on the scene after completed events that did not directly affect them and claim the right to sue. *See Id.* at 153.

Application of the purchaser-seller standing requirement is particularly appropriate here. There actually were purchasers and sellers of the allegedly manipulated securities, none of whom was SIPC. The purchasers and sellers commenced a separate class action which was resolved by settlement. SIPC was not affected by the fraud at the time the alleged fraud was occuring. SIPC arrived on the scene after the alleged acts of racketeering activity were completed. SIPC did not appear until after the brokerage firms' failure to meet required net capital standards had already occurred. SIPC thereafter made payments to brokerage firm customers with account balances entitling them to compensation from SIPC, whether or not the brokerage firm customers were purchasers or sellers in any transactions involving the allegedly manipulated securities.[7] SIPC made these payments not because SIPC was induced to pay by fraud, but because SIPC was mandated to pay by statute. The causal connection between the payments made by SIPC and the manipulation of securities is speculative and tenuous at best, if it exists at all.

If SIPC has standing to sue for these alleged manipulations, causation requirements will have run amuck. The causal connection between the harm complained of, namely the alleged manipulation of the six securities, and injury to SIPC is too attenuated to be legally cognizable and is best dealt with in the context of standing by ruling

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[7] SIPC, of course, was required to advance funds to reimburse *any* non-broker/dealer and non-bank customer of the brokerage firms, unrelated to the management of the brokerage firms, who had a net equity claim against the brokerage firms not satisfied by the customer fund set up under the requirements of SIPA. *See* SIPA §78fff-3. Many of these customers were purchasers or sellers of securities other than those allegedly manipulated.

that SIPC, as a nonpurchaser and nonseller of the manipulated securities, has no standing to sue on account of the alleged manipulation.

The rejection of SIPC's standing, as an entity which has not been injured under civil RICO "by reason of" the predicate act of fraud in the sale of securities, is entirely consistent with and mandated by well-settled principles of standing in securities law and well reasoned judicial decisions involving RICO.

IV.

ON ITS FACE, RICO §1964(c) INCORPORATES BY REFERENCE STANDING REQUIREMENTS UNDER THE EXCHANGE ACT WHEN IT INCORPORATES BY REFERENCE THE BODY OF LAW PERTAINING TO FRAUD IN THE SALE OF SECURITIES.

RICO §1964(c) provides in substance and effect that when a person is injured in his business or property by reason of an act of racketeering activity under §1962, as defined in §1961, such person has standing to sue. "Racketeering activity" is defined as, among other matters, an "offense involving . . . fraud in the sale of securities" (RICO §1961(1)(D)). Viewing §§1964(c), 1962 and 1961(1)(D) together, when "fraud in the sale of securities" is alleged as the predicate act of racketeering activity, for all intents and purposes, §1964(c) should be read as though it provides in relevant part that "a person who is injured in his business or property by reason of fraud in the sale of securities has standing to sue." Viewed in this light, it is apparent that in operation and effect, civil RICO does no more than incorporate by reference and

expressly refer to the body of federal securities law pertaining to "fraud in the sale of securities."[8]

This view is unaffected by the recognition that the complete predicate act is described in RICO §1961(1)(D) as an "offense involving fraud in the sale of securities." Although the term "offense" generally denotes criminal conduct as to which there is no purchaser-seller standing requirement when a criminal action is commenced by the government, the issue here is construction of a civil provision, §1964(c) in actions commenced by private parties.

Even if criminal offenses in securities law prosecuted by the government have no standing requirements and are not subject to the purchaser-seller rule, that does not resolve the interpretation of standing requirements under §1964(c). RICO §1964(c) is part of a group of statutory provisions within §1964, which together are entitled "Civil Remedies." Interpretation of standing under §1964 (c) is governed by civil, not criminal, law rules. This Court has intimated, without resolving, that in setting the burden of proof under §1964, the predicate criminal offenses need be proven only by the civil standard, preponderance of the evidence, not the criminal standard,

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[8] *Cf.* Blakey, *Foreward* to *Law and the Continuing Enterprise: Perspectives on RICO*, 65 Notre Dame L. Rev. 873, 876 (1990) (" . . . RICO does not displace other bodies of law, federal or state . . . The issue was not whether the 1970 Act should apply to the conduct prohibited by its predicate offenses, but whether it should preempt other laws. Congress expressly saved 'provision[s] of Federal, State, or other law imposing criminal penalties or affording civil remedies in addition to those provided for' in RICO" (citing 84 Stat. 947 (1970)).

beyond a reasonable doubt. *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 490-1 (1985). Also, civil RICO §1964 provides a civil remedy in federal court for predicate acts under §1961(1)(A), which under criminal law would be prosecutable in state court only. Courts have generally held that rules of civil law, not criminal law, are applicable to construction of civil RICO §1964(c), even though it incorporates criminal predicate acts. *See Liquid Air Corp. v. Rogers*, 834 F.2d 1297, 1302 (7th Cir. 1987) (and cases collected there). Questions of standing should be resolved no differently. It cannot be fairly said that civil RICO has no standing requirements, merely because it refers to criminal predicate acts, which themselves grant standing only to governmental prosecuting authorities. If one were to argue that civil RICO limits standing to the limits of the criminal predicate acts, that would limit civil RICO standing to government entities, which would contradict the plain wording of §1964(c) granting standing on certain conditions to "any person." Alternatively, the argument that civil RICO grants unlimited standing to "any person" free of any and all restrictions would effectively read out of §1964 the requirements of direct injury contained in the phrase "injured in his business or property" and the causation requirements contained in the phrase "by reason of."

In construing RICO §1964(c) where a "fraud in the sale of securities" is alleged, the majority of courts utilize the already existing body of decisional law under Rule 10b-5. If one of the traditional elements of fraud in a sale of securities as developed in that body of law is missing, such as a duty owed to the seller, there would be no "fraud in the sale of securities" to constitute a predicate act of racketeering activity. In *Moss v. Morgan Stanley, Inc.*,

719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984), the Second Circuit, relying on precedent decided under Rule 10b-5, rather than treating the question as one of first impression under a newly created civil RICO statutory standard, determined that when a shareholder, who unwittingly sold securities of a target company on the open market, was not owed a duty of disclosure under securities law by a purchaser, there was no violation of Rule 10b-5. *Id.* at 15. Accordingly, under civil RICO there was no predicate act of "fraud in the sale of securities" to provide the basis for a civil RICO claim. Once the securities fraud claim was dismissed, the existence of any "racketeering activity" was undercut. In *Chief Consolidated Mining Co. v. Sunshine Mining Co.*, 725 F. Supp. 1191 (D.C. Utah 1989), the district court concluded that all settled elements of a Rule 10b-5 claim, scienter, reliance, materiality and causation, are incorporated in the predicate civil RICO offense of fraud in the sale of securities. Accordingly, the court concluded "that private persons have standing to bring RICO claims based on securities violations under Rule 10b-5 only if they are purchasers or sellers of securities. The arguments articulated in [*International Data Bank*] are persuasive." *Id.* at 1194.

It would be hard to imagine a viable claim of fraud in the sale of securities as a predicate act of racketeering activity if there were no security, no duty, or no causation. Since incorporation by reference into the term."racketeering activity" of "fraud in the sale of securities" carries with it all of the developed body of law as to the elements of fraud in the sale of securities, there is no reason to leave behind the settled body of law pertaining to standing.

Whether standing is considered an element of the underlying offense involving fraud in the sale of securities, or whether the separately developed notion of standing contained in §1964(c) controls, the result is the same where fraud in the sale of securities is relied upon as "racketeering activity." Standing requirements applicable to securities fraud should apply under civil RICO.

The Fourth Circuit in *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987) stated that whether "fraud in the sale of securities" incorporates by reference the standing provisions of securities fraud statutes or whether it limits by its own force the RICO standing to actual purchasers and sellers, either way standing is limited accordingly. *Id.* at 152. The court in *International Data Bank* also noted that all elements of a Rule 10b-5 claim are appropriately incorporated in the predicate offense and it is difficult to conclude that Congress would have insisted on an unexpressed statutory inconsistency, in treating standing requirements differently than other elements of §10(b).

V.

THE RELATIVELY NARROW DEFINITION OF "RACKETEERING ACTIVITY" CONTAINED IN RICO §1961(1)(D) CONSISTING OF AN "OFFENSE INVOLVING FRAUD IN THE SALE OF SECURITIES" REFLECTS AN INTENTION TO PRESERVE APPROPRIATE STANDING LIMITATIONS.

Among all of the definitions of "racketeering activity," the predicate act of an "offense involving fraud in the sale of securities," is the most narrowly defined of the approximately 36 predicate acts listed at RICO §1961(1).

Every other predicate act consists of either every conceivable offense without limitation under a designated statute (*e.g.*, 18 U.S.C.A. §659, relating to theft from interstate shipment) or even more broadly, every conceivable variety and degree of a particular designated category of crime which may be punishable under more than one provision of state law (*e.g.*, murder, kidnapping and arson). If a predicate act of comparable breadth and scope were intended with respect to securities law, the provision pertaining to securities laws could have established as an act of "racketeering activity" any offense under Section 32 of the Exchange Act (15 U.S.C. §77ff), or Section 24 of the 1933 Securities Act (15 U.S C. §77x), which render criminal any wilful violation of the Exchange Act and the Securities Act, respectively. Such a broad definition of securities related crimes would have included not only fraud in the sale of securities, but also proxy rule violations, tender offer violations, and any of the other myriad breaches of duties and responsibilities which do not have purchaser-seller limitations and which, if committed wilfully, may be punishable as crimes under the Exchange Act and the Securities Act. A broader approach was taken in defining the predicate act of bankruptcy fraud where the predicate offense is defined as "any offense involving fraud connected with a case under title 11." RICO §1961(1)(D). *See International Data Bank*, 812 F.2d 149, 152 (4th Cir. 1987).

The relatively narrow and circumscribed statement of the predicate offense with respect to securities, limited to an offense involving fraud in the sale of securities, is unique among the listing of predicate acts of racketeering activity. The narrow statement of the offense reflects an

intention to carve out less than all offenses which may be punishable under a particular statutory section or group of statutory sections. The words "sale of" which modify "fraud" and "securities" constitute a narrowing of the predicate offense. If the modifying words "sale of" had been omitted, any type of securities fraud would have been sufficient as a predicate offense for "racketeering activity." That the predicate offense so narrowly defined actually means what it appears to say was adjudicated by the very Ninth Circuit whose opinion below is here at issue. In *First Pacific Bancorp, Inc. v. Bro*, 847 F.2d 542 (9th Cir. 1988), the Ninth Circuit ruled that failure to comply with a provision of the Exchange Act relating to proxy solicitations, not involving the sale of securities, did not satisfy the requirements of a predicate act of fraud in the sale of securities, so that the civil RICO provisions "have no application. . . . " *Id.* at 546.

This Court has elsewhere recognized that the expansive use of civil RICO is primarily the result of breadth of the predicate offenses. *See H.J., Inc., v. Northwestern Bell Telephone Company*, 492 U.S. 229 (1989). It follows conversely that where the predicate offenses are narrowly circumscribed, as with fraud in the sale of securities, an expansive use of civil RICO is not warranted.

A narrow statement of the scope of the predicate offense suggests that a standing requirement which was judicially developed to limit and sensibly regulate the category of persons entitled to complain of the conduct should not be disregarded, particularly when the offense serves as a predicate act for other and further remedies, such as those of civil RICO.

VI.

IN ADOPTING RICO, CONGRESS DID NOT INTEND TO OVERRULE, ELIMINATE OR EMASCULATE THE PURCHASER-SELLER STANDING REQUIREMENT PERTAINING TO FRAUD IN THE SALE OF SECURITIES.

Generally, when Congress intends to deal with or define a crime or a duty which shall not be breached, Congress is specific. Indeed, the *Birnbaum* court noted that when Congress intended to prevent breaches of fiduciary duty, it was specific. *Birnbaum*, 193 F.2d at 464. A congressional intent to make fundamental changes in a regulatory structure such as that abolishing the purchaser or seller standing requirement in securities fraud should not be lightly inferred. The dissent in *Sedima*, written by Justice Marshall, and joined by Justices Brennan, Blackmun and Powell, stated that one should "not lightly infer a congressional intent" to make "fundamental changes." *Sedima*, 473 U.S. at 501. The *Sedima* dissent further noted that RICO should not be construed to circumvent or trivialize the Exchange Act and the settled law which has developed under the Exchange Act. *See Id.* at 506 (dissenting opinion). Congress did not intend to bring about a dramatic change in commercial litigation when it adopted RICO. Civil RICO was not intended to displace or supersede other federal remedial schemes. *Id.*

Had a principle of limitation of standing so well grounded, so well settled in its implications, as the purchaser-seller requirement been intended to be overruled by RICO, at the very least Congress would have used clear words to do so. While no one will quarrel with

Justice White's statement in *United States v. Turkette*, 452 U.S. 576 (1981), that there is no errorless test for recognizing plain or unambiguous language, particularly in RICO[9], Congress used no language at all to address the question of whether it intended to abolish the purchaser-seller standing limitation settled in securities laws. The question arises as to what follows from Congress' failure to address the purchaser-seller standing rule directly. An argument could be made that Congress' failure to incorporate specifically the purchaser-seller requirement means that Congress did not intend to adopt it. A more persuasive argument is that a statute properly drawn does not address specific cases, as that is the work of a court. A statute sets forth the general concepts by which specific cases are resolved. That was done in §1964(c). By incorporation by reference, use of the "injury" language and use of the phrase "by reason of," Congress has provided the concepts and standards by which the appropriateness of including the purchaser-seller standing rule can be evaluated.

A brief review of the legislative history of RICO is instructive in this respect. At the time RICO passed the Senate, Section 1964(c) in its current form did not exist. *See* S.Rep. No. 617, 91st Cong. 1st Sess. at 24 (1969). Section 1964(c) arose for the first time after the Senate bill had been passed and while the House was considering RICO. *See* Bridges, *Private RICO Litigation Based Upon "Fraud In The Sale Of Securities,"* 18 Ga. L. Rev. 43, 55 and n.83 (1983), [hereinafter "Bridges"].

To the extent the Senate considered other bodies of law at all in relation to RICO, it referred to antitrust law and sought to utilize antitrust remedies as a model for

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[9] *See United States v. Turkette*, 452 U.S. 576, 580 (1981).

interpreting RICO. The Senate did not view antitrust law remedies as something to be cast aside in the wake of RICO. S. Rep. No. 617, 91st Cong. 1st Sess. at 81 (1969). The concept of deferring to and applying other bodies of law without mentioning any criticism of the Exchange Act hardly establishes a basis for concluding that Congress intended to overrule a settled standing principle of securities law. There is no legislative history in the House deliberations with respect to RICO which suggest anything different or any dissatisfaction with the body of securities law including standing limitations which had existed at the time RICO was passed. The Senate noted in its report that the civil remedies under RICO sought economic, not punitive goals. *See Id.*

In *International Data Bank,* the Fourth Circuit noted that Congress wrote RICO against a backdrop of 40 years of federal securities law and that if Congress had intended to overturn the purchaser-seller holding of *Blue Chip Stamps*, "it surely would have done so in a more explicit way." 812 F.2d at 152. Other Rule 10b-5 requirements such as scienter, reliance, materiality and causation are doubtlessly incorporated in the predicate offense. It is difficult to discern why Congress would then have insisted on statutory inconsistency solely with respect to the showing of "injury" required for standing. *Id.* The *International Data Bank* court doubted that Congress meant to overturn *Birnbaum* when it listed securities fraud among numerous qther predicate offenses. The same court thought that with civil RICO, Congress meant to expand the remedies (*e.g.* treble damages and attorneys' fees) rather than to overturn summarily settled principles of standing. *See Id.* at 152-3.

There is no portion of the legislative history of RICO which expressly addresses the issue of the status of the then existing body of securities law and suggests in any manner that Congress was critical of it or desired to change it. Indeed, since the civil RICO provision of Section 1964(c) did not even exist in its present form when approved by the Senate, there could have been no such consideration before the Senate. Congressional silence is an insufficient basis for inferring a dramatic change in the historical structure of commercial litigation in the area of securities law. While RICO is to be construed broadly, it is not to be construed inconsistently, at variance with its legislative history, or contrary to its plain meaning. There is nothing in the mandate of broad construction which suggests a congressional purpose of overturning the well-settled and widely accepted principle of purchaser-seller standing in securities law.

VII.

SOUND AND APPROPRIATE JUDICIAL POLICY REQUIRE THAT WELL-SETTLED AND WIDELY ACCEPTED PRINCIPLES OF STANDING UNDER THE EXCHANGE ACT APPLY UNDER RICO WHEN FRAUD IN THE SALE OF SECURITIES IS ALLEGED AS A PREDICATE ACT OF "RACKETEERING ACTIVITY."

A. It is Appropriate to Consider Matters of Judicial Policy.

Where the statutory language is silent, gray, or unclear, it is proper to consult practical considerations of judicial policy. The court in *International Data Bank* stated that although the RICO right of action is express and the

Rule 10b-5 remedy is implied, many elements of the RICO claim (presumably including standing) have not been clearly legislated. *International Data Bank*, 812 F.2d at 153. As to those elements, the court thought it proper and prudent to consult the practical considerations of *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), the landmark decision which established the requirement that a plaintiff be a purchaser or seller of securities in order to have standing to present a claim for securities fraud under the Exchange Act. *See Id.*

This Court has recognized that "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors" and this Court shared "the doubts of the Court of Appeals [for the Second Circuit] about this increasing divergence." *Sedima*, 473 U.S. 479, 500 (1985).

The dissent in *Sedima* noted that it is particularly important to construe civil RICO carefully because in civil RICO, unlike criminal RICO, the responsible use of prosecutorial discretion as a restraining influence is absent. *See Sedima*, 473 U.S. at 504-505 (Marshall, Brennan, Blackmun and Powell JJ., dissenting).

The essential injustice in the ruling on standing of the court below is that it permits a person who would have no standing under the Exchange Act to obtain an even more extreme remedy, treble damages and attorneys' fees, under RICO for the very same conduct. The effect of such a holding is to enable persons who would not be entitled to standing under the Exchange Act to circumvent the Exchange Act and thereby trivialize and emasculate the carefully crafted protections which a body of

judicial decisions have built into the law over 40 years of development. The dissent in *Sedima* recognized under the circumstances there present, such a result should not be permitted. Here, where the issue is squarely before the Court, the point of view which was shared by four justices in the *Sedima* dissent with respect to a matter not there required to be passed upon by the Court, now merits adoption by a majority of the Court.[9]

In its recent substantive pronouncement on RICO, this Court noted that in *Sedima*, "this Court rejected a restrictive interpretation of §1964(c). . . . In doing so, we acknowledged concern in some quarters over civil RICO's use against 'legitimate' businesses,. . . . " *H.J., Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 106 L.Ed.2d 195, 205 (1989).

Under these circumstances, with an absence of express congressional intent and an apparent dispute about the meaning of the statutory language, as well as concern over possible misuse and abuse of civil RICO, it is appropriate for this Court to consult with judicial policy considerations in resolving the question as to which certiorari has been granted.

B. The Policy Considerations Which Led to Adoption of the Purchaser-Seller Standing Requirement Apply With Even More Force When Securities Fraud is Alleged as a Predicate Act of "Racketeering Activity."

In ruling that a person must be a purchaser or seller of securities to have standing to complain of fraud "in

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[9] *See Sedima*, 473 U.S. at 505 (Marshall, Brennan, Blackmun and Powell JJ., dissenting).

connection with" the sale of securities under the Exchange Act, the Court in *Blue Chip Stamps*, 421 U.S. 723 (1975), cited *Birnbaum*, 193 F.2d 461, a landmark opinion decided by the Second Circuit. After determining that the intent of Congress could not be divined with respect to interpretations of Rule 10b-5 under the Exchange Act and noting that the Court was dealing with "a judicial oak which has grown from little more than a legislative acorn," a development unforeseen by Congress, the *Blue Chip Stamps* Court stated, "It is therefore proper that we consider, in addition to the factors already discussed, what may be described as policy considerations when we come to flesh out the portion of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance." *Blue Chip Stamps*, 421 U.S. at 736-737.

The Court in *Blue Chip Stamps* noted, "[t]here has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Id.* at 739. In securities law, even a complaint which by objective standards has very little chance of success at trial has a settlement value out of proportion to the prospects for success at trail, so long as the plaintiff can prevent the suit from being dismissed by motion. *Id.* The Court in *Blue Chip Stamps* also noted the potential for abuse of discovery and that, in connection with Exchange Act litigation, it is easy to allege a case but hard to prove it, and there is a great risk of strike suits. *Id.* at 740-42. A standing rule limiting the class of plaintiffs to purchasers and sellers separates out prospective plaintiffs who are more likely to be believed and are less

likely to bring strike suits. An opening of the gates of standing would have the effect of throwing "open to the trier of fact many rather hazy issues of historical fact. . . ." *Id.* at 743. In sum, this Court acknowledged its "concern that . . . broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good." *Id.* at 748. The concurring opinion went even further and stated, "A rule allowing this type of open-ended litigation [free of standing limitation] would itself be an invitation to fraud." *Id.* at 761 (Powell, Stewart and Marshall, JJ., concurring).

The very considerations expressed in *Blue Chip Stamps* with respect to limiting standing under Rule 10b-5 apply with equal if not greater force under RICO. Litigation under civil RICO is inherently vexatious and complaints with little chance of success have a disproportionate settlement value. In this case, which has been pending for almost eight years, it is evident, from an examination of the docket, which reflects that the case has not yet gone to trial, and has been appealed to the Ninth Circuit three times, that attorneys' fees on each side have been massive. Attorneys' fees alone have already far exceeded the amount paid in settlement to the class representatives of the purchasers and sellers of the allegedly manipulated securities, in the consolidated companion class action. Holmes appears to be a rare civil RICO defendant who is willing to fight the RICO charges at great expense. The massive and costly scope of this battle only serves as a deterrent to other defendants, and only serves to illustrate the reasons for the premium generally placed on settling civil RICO cases at irrationally disproportionate amounts.

Under RICO, as under the Exchange Act, broadening standing would unduly burden the judicial system when the questions raised by standing can best be resolved at the outset by the court. Under RICO as under the Exchange Act, broadening standards would result in more harm than good and would itself be an invitation of fraud. *See Blue Chip Stamps*, 421 U.S. at 761 (Powell, Stewart and Marshall, JJ., concurring). Civil RICO, like the Exchange Act, has been used for extortive purposes, as was recognized by the dissent in *Sedima*. *See Sedima*, 473 U.S. at 365 (Marshall, Brennan, Blackmun and Powell, JJ., dissenting).

C. Disregarding The Purchaser-Seller Standing Limitation Under RICO Would Unjustly Emasculate and Trivialize a Well-Settled and Widely Accepted Principle of the Law of Securities Fraud.

The obvious practical consequence of the expanded standing sought by SIPC here is that a person who lacks standing to sue for fraud in the sale of securities under the Exchange Act could sue for the very same conduct under RICO and obtain an even more extreme remedy. To permit such a result would in effect eliminate the well-settled and widely accepted standing requirement under the Exchange Act, since persons who could not satisfy it would simply sue under RICO and circumvent the requirement.

The effect of such a rule of open standing would be to turn well-settled and widely accepted principles of commercial litigation on their head, without any mandate

to do so from Congress or any sound reason in judicial policy to accomplish such a result. There is no reason to eliminate the purchaser-seller standing requirement from the body of settled commercial litigation principles and it should not be done. If a person is unable to state a claim under the Exchange Act for fraud in the sale of securities, for whatever reason, whether for lack of an element of the claim or for lack of standing to assert the claim, such a claim would be dismissed if maintained in a separate action under the Exchange Act. A claim which is capable of being dismissed should not suffice as a predicate act to invoke the additional remedies of civil RICO.

In *Brannan v. Eisenstein*, 804 F.2d 1041 (8th Cir. 1986), the Eighth Circuit dismissed a claim under Rule 10b-5 for lack of standing, finding that plaintiffs were neither purchasers nor sellers of securities, stating:

> Since we have already found that the directors' state and federal securities fraud claims . . . were properly dismissed, the directors may not rely upon the same conduct as the basis of any securities fraud that may constitute racketeering activity.

Id. at 1046.

The Second Circuit reached a similar result, ruling that where a complaint failed to allege a fraud with respect to a securities' sale, there was no predicate securities fraud to support a claim of racketeering activity. *See Moss v. Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983).

VIII.

THE DECISION BELOW SHOULD BE REVERSED AND THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE CIRCUITS BY ADOPTING THE VIEWS EXPRESSED BY THE FOURTH CIRCUIT ON RICO STANDING.

Based upon the foregoing, it is apparent that the decision below was deficient in numerous respects. In the first instance, the court below based its ruling on the conclusion that, "[o]n its face, the RICO statute has no purchaser-seller standing requirement." *Securities Investor Protection Corp. v. Vigman*, 908 F.2d 1461, 1466 (1990). This conclusion is baldly stated without adequate support. The court below did not consider the argument that the very words in RICO §1964(c) that "any person injured in his business or property" require demonstrating a direct injury, which a non-purchaser or non-seller of securities does not have. The court's statement also ignores the requirement contained plainly in §1964(c) that for standing to exist, the injury must be "by reason of" a fraud in the sale of securities, requiring a causal connection between the sale of securities and the damage. A non-purchaser or non-seller cannot show the requisite causal connection.

The decision below also ignores the argument that the definition of racketeering activity as "fraud in the sale of securities" incorporates by reference the developed standing requirements applicable to fraud in the sale of securities. If there are sound reasons for rejecting these views (and petitioner Holmes does not believe there are), they were not identified or discussed by the court below. The decision below on its face offers insufficient consideration of the statutory text of RICO.

In addition, the court below relied upon the idea that RICO contains an express remedy while the Exchange Act and Rule 10b-5 involve remedies implied by courts and that it is more appropriate to limit implied remedies than to limit express remedies. *Id.* The problem with this view, however, is that it does not consider the argument that the standing limitation is inherent in the civil RICO remedy as expressed by Congress in §1964(c). The express-implied remedy distinction need not be reached in order to ascertain the appropriate standing requirement for RICO. It is not the mere statement of an express remedy that governs its interpretation but rather all of the circumstances, including congressional history, plain meaning of the language of the statute and, where appropriate as here, policy considerations.

Finally, the court below states as a basis for its decision the widely accepted and undisputed view that "RICO is to be read broadly." *Id.* Merely acknowledging that RICO should be read broadly, however, is not a sufficient basis for resolving the question before this Court. When faced with an analogous question construing the Exchange Act, the *Birnbaum* court stated that it did not doubt that Congress was motivated by a broad purpose to protect investors. Nevertheless, the precise question then before the court had to do with the means chosen to further that end. Merely acknowledging Congress' broad purpose did not provide a basis for resolving the question before the court with regard to standing. *See Birnbaum*, 193 F.2d at 464.

The court below did not deal with, much less try to reconcile, the conflict between judicial circuits with respect to the question presented here. No mention was

made by the court below of the well reasoned contrary decision of the Fourth Circuit in *International Data Bank,* which was expressly cited to the court below by Holmes. In *Warner v. Alexander, Grant and Co.,* 828 F.2d 1528 (11th Cir., 1987), the Eleventh Circuit stated in passing:

> "The federal RICO statute has no requirement analogous to the 'purchase or sale' requirement of the federal securities laws." *Id.* at 1530.

The *Warner* court however, presented no reasoning or explanation as a basis for the quoted language. From an examination of the text of the decisions, it is evident that *International Data Bank* is a reasoned decision, while the decision below and that of *Warner* are conclusory at best. In addition, as argued herein, *supra,* the reasoning set forth in *International Data Bank* by the Fourth Circuit is sound and should be followed by this Court.

This Court has already found the mandate to construe RICO broadly to be an insufficient basis for deciding certain questions before it and has stated that it would reach its decision, "[w]ith or without this admonition" that the provisions of RICO shall be "liberally construed to effectuate its remedial purposes." *See U.S. v. Turkette,* 452 U.S. 576, 587 (1981). In the *Sedima* dissent, Justice Powell noted:

> We ruled in Turkette and Russello that the statute must be read broadly and construed liberally to effectuate its remedial purposes, but like the legislative history to which the Court alludes, it is clear we were referring there to

> RICO's *criminal* provisions. It does not necessarily follow that the same principles apply to RICO's private civil provisions.

473 U.S. at 529 (Powell, J., dissenting).

In a concurring opinion in *H.J., Inc. v. Northwestern Bell Telephone Company,* 492 U.S. 229, 106 L.Ed.2d 195, 215 (1989), Justice Scalia, writing for himself with Justices Rehnquist, O'Connor and Kennedy joining, stated that the reaction to *Sedima* "promptly produced the widest and most persistent circuit split on an issue of federal law in recent memory" and that the Court was still being faced years and countless millions in damages and attorneys' fees later with some of the same questions. In effect, Justice Scalia said that a statute should be more helpful than stating "life is a fountain." 106 L. Ed. 2d at 215. To say that RICO should be construed broadly is an invitation to spray the fountain water of standing liberally in all directions. The plain language of RICO does not require such a result and while RICO is to be construed broadly, it is not to be construed inconsistent with its plain meaning, particularly when the mandate to construe broadly is of uncertain application to the civil RICO provisions here at issue. "Broadly" does not mean revolutionary, erratically or inconsistent with the plain meaning of the statute.

IX.

THE PURCHASER-SELLER STANDING REQUIREMENT OF FRAUD IN THE SALE OF SECURITIES SHOULD NOT BE CIRCUMVENTED BY PERMITTING THE PLEADING OF WIRE OR MAIL FRAUD AS A PREDICATE ACT OF RACKETEERING ACTIVITY ABSENT A SHOWING OF REQUISITE SECURITIES FRAUD STANDING.

It has been suggested in more than one quarter that RICO may have been a poorly drafted statute. *See, e.g.*

H.J. Inc., 492 U.S. 229, 106 L.Ed.2d at 214 ("RICO may be a poorly drafted statute . . . "); *Id.* at 217-18 (Scalia, J., concurring) (vagueness of "pattern" requirement); Bridges at 47 (courts have interpreted RICO provisions in inconsistent ways). This Court has said as much in *H.J., Inc.* although acknowledging that rewriting RICO is a job for Congress if it is so inclined and not for this Court. 106 L. Ed. 2d at 214. However, sensibly construing what there is of RICO is the responsibility of the courts.

As RICO now stands, there is a significant "loophole" in applying the requirement of purchaser-seller status for standing when fraud in the sale of securities is alleged as a predicate act of racketeering activity. The loophole is that even if a purchaser-seller standing requirement is made applicable, it may be circumvented by the device of pleading wire and mail fraud as predicate acts of racketeering activity as well as pleading securities fraud. That is what SIPC has done here. It would be cold comfort to the integrity of standing to enforce standing rigorously with respect to fraud in the sale of securities as a predicate act and open up the floodgates when the same conduct is alleged to constitute wire and mail fraud. Allegations of wire and mail fraud are particularly easy to make in the context of securities as invariably a telephone or mailing would have been made to someone even if the person who received the telephone call or mailing was not the actual victim of the fraud.[10]

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[10] The predicate acts of wire and mail fraud contain their own separate standing requirements which SIPC will

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The same principles of construction and interpretation of RICO §1964(c) should apply when the same conduct that is alleged to constitute "fraud in the sale of securities" as a predicate act of racketeering activity is alleged to constitute wire and mail fraud as a predicate of "racketeering activity." SIPC is no more injured directly by the conduct at issue when it is pleaded as mail or wire fraud than it was by pleading fraud in the sale of securities. Also, SIPC's causal connection to the harm complained of is just as tenuous when it casts the challenged conduct as wire or mail fraud than it is when SIPC classifies the conduct as "fraud in the sale of securities."

Wire and mail fraud were crimes without civil counterparts prior to the passage of RICO. *See* J.S. Rakoff and H.W. Goldstein, *RICO: Civil and Criminal Law Strategy* §2.02[1] (1991). There was no developed law of standing

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probably be unable to satisfy. SIPC will probably be unable to show that it relied on any misrepresentation of the defendants. *See Pelletier v. Zweifel*, 921 F.2d 1465, 1499-1500 (11th Cir. 1991); *County of Suffolk v. Long Island Lighting Co.*, 907 F.2d 1295, 1311 (2d Cir. 1990); *Brandenburg v. Seidel*, 859 F.2d 1179, 1188 n.10 (4th Cir. 1988).

In addition, SIPC will probably be unable to show that it was a "target" of the alleged scheme to defraud. *See Pelletier*, 921 F.2d at 1499 (11th Cir. 1990); *Sperber v. Boesky*, 849 F.2d at 64-66 (2d Cir. 1988); *Brandenburg*, 859 F.2d at 1188 (4th Cir. 1988).

with respect to these offenses as only prosecutorial authorities had standing to bring actions alleging these offenses prior to RICO. When the gist of the predicate act of which plaintiff complains sounds in securities fraud, whether or not it is openly alleged as such, the standing requirements contained in §1964(c) applicable to securities fraud should be equally applicable even if the allegations are recast in terms of wire and mail fraud.

The Eighth Circuit has considered this question and ruled accordingly without a lengthy explanation. In *Brannan v. Eisenstein*, 804 F.2d 1041 (8th Cir. 1986), the Court stated:

> Since we have affirmed the dismissal of the securities fraud claims, the same conduct cannot constitute a fraudulent scheme giving rise to a wire fraud claim. Thus, wire fraud also fails as a basis for racketeering activity.

Id. at 1047.

This reasoning should be adopted by this Court to implement the requirements in mail and wire fraud as a civil RICO predicate act that when fraud in the sale of securities is involved a person must be a purchaser or seller of securities to have standing under §1964(c).

X.
CONCLUSION

Civil RICO is not entirely a world of its own. When it attaches special consequences to conduct which the law already has categorized and regulated, such as "fraud in the sale of securities," the developed body of experience

and settled law, including provisions pertaining to standing, should be utilized in construing the relevant provisions of RICO. Even if the construction of civil RICO standing requirements is approached without reference to settled securities law decisions, the result is the same. A person who is neither a purchase nor seller of securities is not directly injured by, or injured by reason of, the fraud in the sale of securities and should not have standing under RICO §1964(c).

Respectfully submitted,

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